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ACTION NEA-13

INFO OCT-01 ISO-00 AGR-20 AID-20 CIAE-00 COME-00 EB-11

FRB-02 INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12

SPC-03 CIEP-02 LAB-06 SIL-01 OMB-01 SAM-01 NSC-10

SS-20 STR-08 CEA-02 L-03 H-03 PRS-01 PA-04 USIA-15

EUR-25 EA-11 FEA-02 INT-08 DRC-01 /224 W

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R 120930Z FEB 74

FM AMEMBASSY COLOMBO

TO SECSTATE WASHDC 522

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EO 11652: N/A

TAGS: EFIN, EAID, CE

SUBJ: IMF TEAM VISITS SRI LANKA: EARLY FEBRUARY 1974

SUMMARY: IMF TEAM DEPARTED FEB 9 FOLLOWING EIGHT-DAY ARTICLE XIV CONSULTATIONS. IN MEETING WITH AID GROUP AMBASSADORS AND IN PRESS INTERVIEWS, TEAM LEADER NARVEKAR MADE FOLLOWING MAIN POINTS: 1) GSL'S ATTITUDE, POLICIES, AND ACTIONS ARE MUCH BETTER THAN THEY APPEARED DURING LAST VISIT; 2) SRI LANKAS SHORT-AND-MEDIUM-TERM FINANCIAL SITUATION IS VERY DIFFICULT BUT SURVIVABLE; AND 3) OUTLOOK IS IMPROVED FOR STANDBY, COMPENSATORY FINANCING AND A BETTER GSL-IMF WORKING RELATIONSHIP. END SUMMARY.

1. FEBRUARY 7 AMBASSADOR VAN HOLLEN OFFERED DRINKS FOR FIVE-MAN IMF TEAM LED BY P R NARVEKAR PLUS AID GROUP AMBASSADORS (UK, CANADA, AUSTRALIA, FRANCE, FRG, ITALY, JAPAN). IN CORDIAL ATMOSPHERE NARVEKAR GAVE GENERAL BRIEFING ON TEAMS INITIAL IMPRESSIONS AND ANSWERED SPECIFIC QUESTIONS.

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2. NARVEKAR BEGAN BY SAYING "WE ARE VERY MUCH IMPRESSED..."

WITH GSLS CHANGED ATTITUDE TOWARD ECONOMIC PROBLEMS. TO SUPPORT THIS HE CITED: A) RELATIVELY REDUCED NET FOOD SUBSIDIES FOLLOWING OCT 1 AND SUBSEQUENT RATION AND FOOD PRICE CHANGES; B) INCREASED GSL DIRECT SUPPORT FOR MAJOR EXPORTS, SPECIFICALLY MENTIONING RS 625 MILLION TEAM PROGRAM ANNOUNCED SHORTLY AFTER NOVEMBER BUDGET; AND C) GOVTS EFFORT TO PASS EXTERNAL PRICE INCREASED THROUGH TO CEYLONSE CONSUMERS. IN MENTIONING OTHER POSITIVE POLICY DEVELOPMENTS HE SUMMED UP BY SAYING "DIRECTION IS GOOD".

3. THEN ADDRESSING REALITIES OF ECONOMIC CIRCUMSTANCES BEYOND SRI LANKAS CONTROL, HE POINTED OUT THAT TEA WAS ONE OF VERY FEW (BANANAS, CITRUS) MAJOR WORLD COMMODITIES WHICH HAD NOT ENJOYED BOOM OVER LAST YEAR. HE DID NOT COVER IN DETAIL IMPACT OF OIL CRISIS, SIMPLY SAYING IT IS NOW A GIVEN WPTCH WILL HAVE ENORMOUS AND AT PRESENT INCALCULABLE IMPACT ON ANY DEVELOPING COUNTRYS NEAR-TERM ECONOMIC FORTUNES. HE MENTIONED POSITIVE EXTERNAL FACTORS INCLUDING RUBBER PRICES AND GEM EARNINGS DURING 1973. CONCLUSION OF HIS INTRODUCTORY REMARKS WAS THAT TEAM MUCH MORE SYMPATHETIC TOWARD GSL'S ECONOMIC ATTITUDE, POLICIES AND RECENT ACTIONS BUT STILL EXTREMELY CONCERNED ABOUT NEAR-AND MEDIUM-TERM FINANCIAL PROSPECTS.

4. SUMMARIZED QUESTIONS AND ANSWERS ARE AS FOLLOWS:

A) DEBT/DEBT RESCHEDULING: IMPLYING THAT DEBT SIMPLY IS NOT A CRITICAL SHORT-TERM ISSUE FOR GSL, NARVEKAR SAID RESCHEDULING NOT DISCUSSED.

B) DEVALUATION: IN WELL-UNDERSTOOD CONTEXT THAT GSL HAS CONSTRUED THIS IN PAST AS IMF BOGEYMAN, NARVEKAR SAID HE DID NOT REALLY KNOW WHEAT DEVALUATION WOULD MEAN FOR SRI LANKA GIVEN ITS EXTREMELY COMPLEX MULTIPLE EXCHANGE RATE AND EXPORT TAXATION SYSTEM. HE INDICATED THAT FORMAL DEVALUATION PER SE IS NOT AN ISSUE OF MOMENT FROM IMF STANDPOINT.

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C) PAST GSL IDEOLOGICAL CRITICISM OF IMF: FOLLOWING REFERENCE TO PAST DIFFICULTIES IN GSL/IMF RELATIONS BY OUR AMB, NARVEKAR GOOD-HUMOREDLY SHOWED AWARENESS OF EARLIER CRITICAL CEYLONSE MINISTERIAL AND PRESS STATEMENTS ABOUT IMF/WORLD BANK, BUT SAID GSL/IMF DIFFERENCES HAVE BEEN GREATLY EXAGGERATED.

D) POLITICAL DANGERS OF CURRENT INTERNAL ECONOMIC STRESSES: NARVEKAR EXPRESSED STRONG INTEREST IN AMB VAN HOLLENS DISCUSSION OF THIS AND LISTENED ATTENTIVELY

TO UK HIGH COMMISSIONERS POINT THAT GSLS ACCELERATED PASSING-THROUGH EXTERNAL PRICE RISES COULD RAISE COST OF LIVING SO FAST THAT UNION WAGE PRESSURES AND SUBSEQUENT LABOR UNREST COULD RESUME AFTER TWO-YEAR HIATUS.

E) FOREIGN ASSISTANCE POSSIBILITIES: NARVEKAR WAS INTERESTED IN AID GROUP MEMBERS THINKING ON 1974 AID TO SRI LANKA BUT OF COURSE AMBS WERE NON-COMMITTAL EXCEPT FOR APPARENT CONSENSUS ON DESIRABILITY OF SPRING AID GROUP MEETING.

F) SUCCESS OF FOOD DRIVE: NARVEKAR SAID IMPOSSIBLE TO MEASURE RESULTS BUT TEAM WAS IMPRESSED BY EFFORT GSL HAD MADE.

G) FINANCIAL PROJECTIONS: NARVEKAR AGREED WHEN ONE AMB MENTIONED WORLD BANK TEAMS STATEMENT DURING ITS VISIT THAN EVEN GENERAL PROJECTIONS FOR 1974 WERE VIRTUALLY IMPOSSIBLE BECAUSE OF EXPORT PRICES AND IMPORTED FOOD/FUEL COST UNCERTAINTIES. HE SEEMED TO REFLECT, HOWEVER, PRELIMINARY CONCLUSION THAT COUNTRY CAN MUDDLE THROUGH DESPITE ENORMOUS STRESS ON FINANCIAL RESOURCES.

H) STANDBY/COMPENSATORY FINANCING: EXPLAINING THAT MUCH DISCUSSED \$24.5 MILLION FIGURE RELATED TO IMF TRANCHE AND ASSOCIATED IMF POLICY DISCIPLINE REQUIREMENTS, NARVEKAR SAID THAT DECISION WOULD HAVE TO BE TAKEN IN WASHINGTON FOLLOWING ISSUE AND REVIEW OF REPORT BUT WHOLE TENOR OF HIS REMARKS INDICATED FAVORABLE EXPECTATION WOULD BE JUSTIFIED. ON COMPENSATORY LIMITED OFFICIAL USE
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FINANCING, NARVEKAR SAID DEMONSTRATED 1973 BALANCE PAYMENTS SHORT-FALL APPEARED TO JUSTIFY ABOUT \$6 MILLION FACILITY LATER THIS YEAR.

5. IN CONCLUDING HIS REMARKS, NARVEKAR REINFORCED GENERAL IMPRESSION OF OPTIMISM WITH RESPECT TO GSL PERFORMANCE BY SAYING THERE WAS "CERTAINLY A BETTER EFFORT". HOWEVER, HE SAID, CURRENT EVEN MORE DIFFICULT INTERNAL AND EXTERNAL SITUATION MAKES ENERGETIC AND POSITIVE GSL ACTION ABSOLUTELY ESSENTIAL TO MAINTAIN RELATIVE ECONOMIC STABILITY IN NEAR FUTURE.

6. ALMOST ALL OF POINTS MADE IN MEETING WITH AID GROUP AMBS HAVE BEEN COVERED IN STRAIGHT DAILY NEWS (FEB 9) AND DAILY MIRROR (FEB 11) ARTICLES, INCLUDING DIRECT QUOTATION OF NARVEKAR TO EFFECT "WE ARE CERTAINLY IMPRESSED..." WITH OVERALL ECONOMIC MEASURES AND FOOD DRIVE.

7. EVENING FOLLOWING MEETING WITH AMBS, IMF GAVE
RECEPTION FOR FINANCE MINISTER, WIDE VARIETY
SENIOR GSL OFFICIALS AND DIPLOMATIC PEOPLE.

8. COMMENT: IMF TEAM DID NOT UNDERSTATE SRI LANKA'S
CONTINUING CRITICAL SHORT-TERM ECONOMIC SITUATION AND HAD
LITTLE TO SAY ABOUT ANY IMPROVEMENT IN SAVINGS/INVESTMENT OR
REAL GROWTH. THEY DID, HOWEVER, UNEQUIVOCALLY AND PUBLICLY
JOIN GROWING CONSENSUS THAT GSL HAS RECONGIZED REALITIES
OF ECONOMIC CIRCUMSTANCES AND, ADMITTELDLY WITH LITTLE
CHOICE, HAS ACTED FORCEFULLY AND AT CONSIDERABLE POLITICAL RISK
TO IMPROVE COUNTRYS SITUATION AND PROSPECTS.
VAN HOLLEN

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Message Attributes

Automatic Decaptioning: X
Capture Date: 01 JAN 1994
Channel Indicators: n/a
Current Classification: UNCLASSIFIED
Concepts: ITINERARY, VISITS, ECONOMIC CONTROLS, ECONOMIC REPORTS
Control Number: n/a
Copy: SINGLE
Draft Date: 12 FEB 1974
Decaption Date: 01 JAN 1960
Decaption Note:
Disposition Action: RELEASED
Disposition Approved on Date:
Disposition Authority: MorefiRH
Disposition Case Number: n/a
Disposition Comment: 25 YEAR REVIEW
Disposition Date: 28 MAY 2004
Disposition Event:
Disposition History: n/a
Disposition Reason:
Disposition Remarks:
Document Number: 1974COLOMB00413
Document Source: CORE
Document Unique ID: 00
Drafter: n/a
Enclosure: n/a
Executive Order: N/A
Errors: N/A
Film Number: n/a
From: COLOMBO
Handling Restrictions: n/a
Image Path:
ISecure: 1
Legacy Key: link1974/newtext/t19740240/aaaablal.tel
Line Count: 183
Locator: TEXT ON-LINE
Office: ACTION NEA
Original Classification: LIMITED OFFICIAL USE
Original Handling Restrictions: n/a
Original Previous Classification: n/a
Original Previous Handling Restrictions: n/a
Page Count: 4
Previous Channel Indicators: n/a
Previous Classification: LIMITED OFFICIAL USE
Previous Handling Restrictions: n/a
Reference: n/a
Review Action: RELEASED, APPROVED
Review Authority: MorefiRH
Review Comment: n/a
Review Content Flags:
Review Date: 23 AUG 2002
Review Event:
Review Exemptions: n/a
Review History: RELEASED <23 AUG 2002 by izenbei0>; APPROVED <04-Sep-2002 by MorefiRH>
Review Markings:

Declassified/Released
US Department of State
EO Systematic Review
30 JUN 2005

Review Media Identifier:
Review Referrals: n/a
Review Release Date: n/a
Review Release Event: n/a
Review Transfer Date:
Review Withdrawn Fields: n/a
Secure: OPEN
Status: NATIVE
Subject: IMF TEAM VISITS SRI LANKA: EARLY FEBRUARY 1974 SUMMARY: IMF TEAM DEPARTED FEB 9 FOLLOWING EIGHT-
TAGS: EFIN, EAID, CE, IMF
To: STATE
Type: TE
Markings: Declassified/Released US Department of State EO Systematic Review 30 JUN 2005